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40 Letters Per Year

Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

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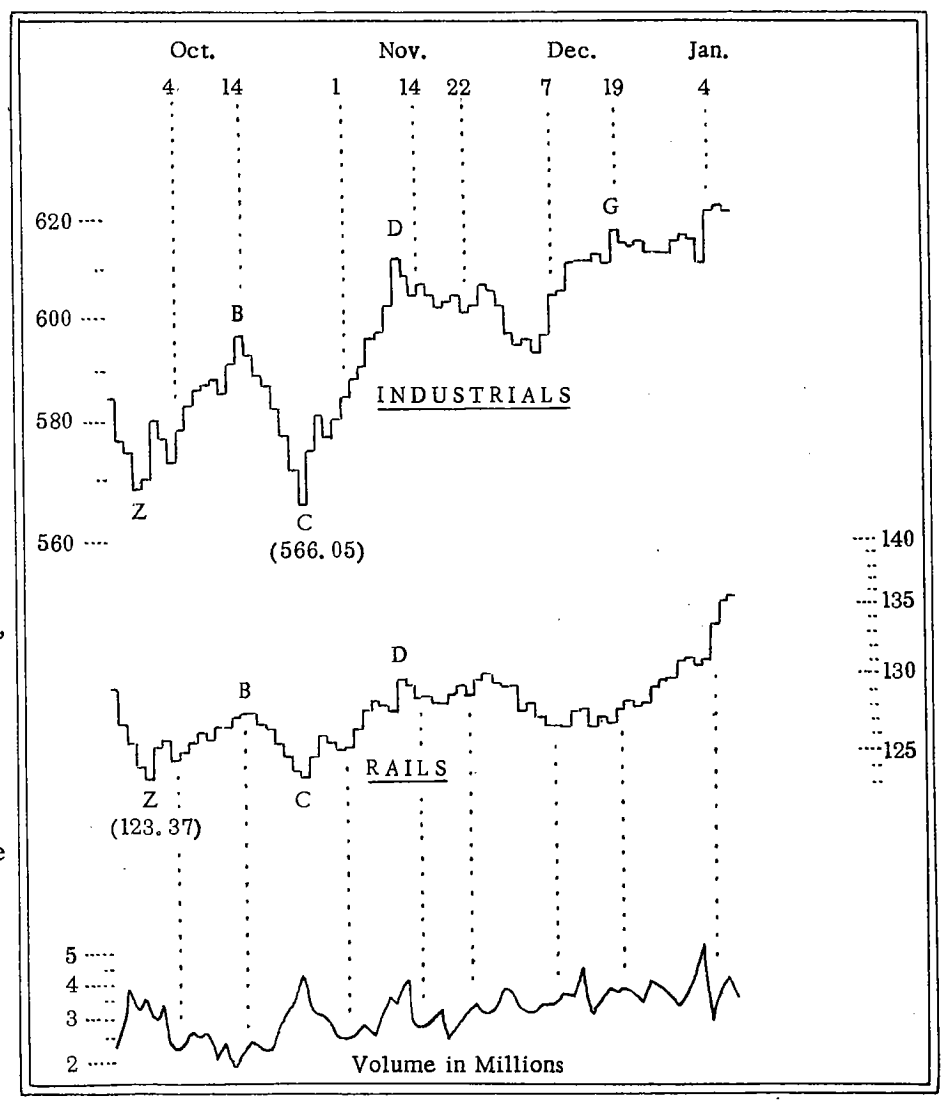
THE MARKET "When a secondary reaction is in the making, the question is often asked, 'How far will it go?' Under the implications of the Averages, one is reasonably safe in saying that important secondary movements generally retrace from 1/3 to 2/3 or more of the ground lost since the termination of the last major interruption of the market. This generalization can be tremendously useful, but those who try to place exact limits on secondary reactions are doomed to failure just as surely as would be the weather man who forecasted a snowfall of exactly three and one half inches within a specified time. The latter is generally right about the snow and the approximate date on which it will occur, but he cannot successfully name the hour of the storm or the depth of the snowfall. The student of the Dow Theory is in a similar position." (Robert Rhea)

On January 3, the first trading day of the new year, Industrials dropped 5.69 points to close below the entire trading range of the preceding three weeks. Rails would not confirm the move (Rails actually closed up on the day), and for this reason the Industrial action was considered meaningless. On January 4 Industrials advanced above point G to a new secondary recovery high, thereby confirming the previous indication of the Rails. This action together with the extended advance of the previous three months served to fortify many observers in their opinion (1) that the business recession is now over, and (2) that a new bull market has begun. From the standpoint of Dow's Theory no such conclusion can be drawn at this time.



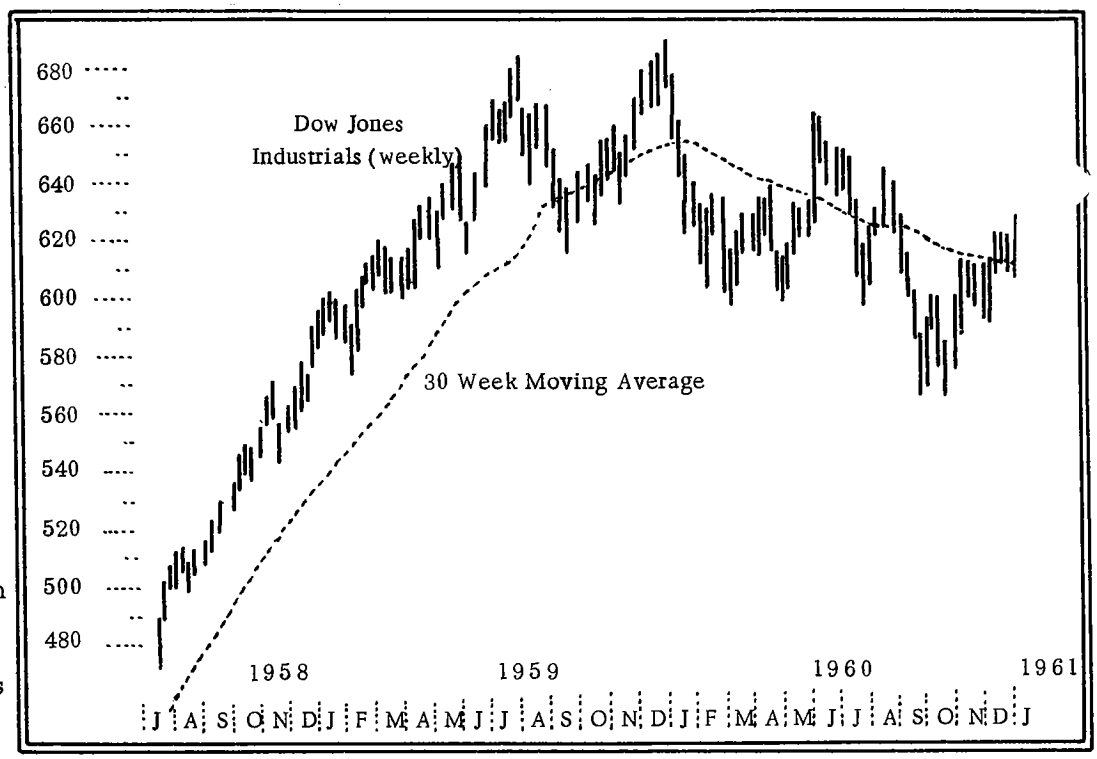
But let us assume the bullish viewpoint. If the advance since Z-C has been part of the first leg of a new bull market, it is a most unusual bull market in that it was not preceded by evidence of a major bear market bottom (see Letter 127). If, for the sake of argument, we are now in a new bull market (which has started without the usual characteristics of low volume, extreme pessimism, high yields, etc.), it would nevertheless pay to wait for the eventual downward correction of the first upward leg. Following a decline which (1) lasted three weeks or more, and (2) corrected 1/3 to 2/3 of the advance since Z-C, if volume dried up and pessimism became rampant, we would then have a logical spot in which to take on at least speculative commitments. Such purchases would have to be made with the stipulation that they would be sold if both Averages

As far as Dow's Theory is concerned, however, the safe (and orthodox) procedure is to take the advance since Z-C as part of a normal secondary (upward) reaction which has lasted just over three months and which has corrected 62% of the preceding Industrial decline, 52% of the preceding Rail decline. As stated frequently in these Letters, the writer continues to think and act along the lines dictated by orthodox Dow Theory.

CONCLUSION The primary trend continues bearish. The secondary and minor trends were reconfirmed as bullish when Industrials bettered point G.

NOTE A subscriber (and friend) who has recently returned from a long stay in Paris has written an interesting letter. One paragraph in particular strikes my eye: "There was panic in 1929, depressed sentiment after April, 1930. There has been no panic in this market so far, only surprises and a little dismay. It is conceivable that we may never have a panic in this market -- just 4-5 years of undulating erosion, providing all God's time for whipsawing the 'smart boys' ' accounts away. A panic saves a lot of people which this type of action would not save. This bear market ('no two bear markets are alike,' c.f. Russell) may turn out to be a teaser." (B. Baekeland, N.Y.C.)

THIRTY WEEK MOVING AVERAGE (M.A.) The relationship of the D-J Industrials to their own thirty week moving average (see Letters 112, 119) is at an interesting juncture. The M.A. consists of the total of the previous thirty Industrial closings (taken on Wednesdays) divided by thirty. On each successive Wednesday a new figure is added to the list while the thirty-first figure is dropped and the total is again divided by thirty. The resultant figure represents the average price which investors have been willing to pay for the Industrials during the preceding seven months (thirty weeks).



Note that in September, 1959, for the first time during the entire 1958-59 advance, the Industrials plunged below the M.A. But the tremendous momentum of a ten-year bull market was not easily terminated, and on the rally which ended January 5, 1960, the Industrials rose 32 points above the M.A. Another primary downward leg ensued, following which the rally to the June, 1960 highs advanced Industrials 24 points above the M.A. Again Industrials dropped back, only to push forward to the August high which was 17 points above the M.A.

On the current advance Industrials have succeeded (so far) in rising 11 points above the M.A. (the M.A. is now 611.64). It will be most interesting to see if the Industrials will now repeat their performances of January, June and August, 1960, or whether they can hold abov the M.A., gather strength and work higher.

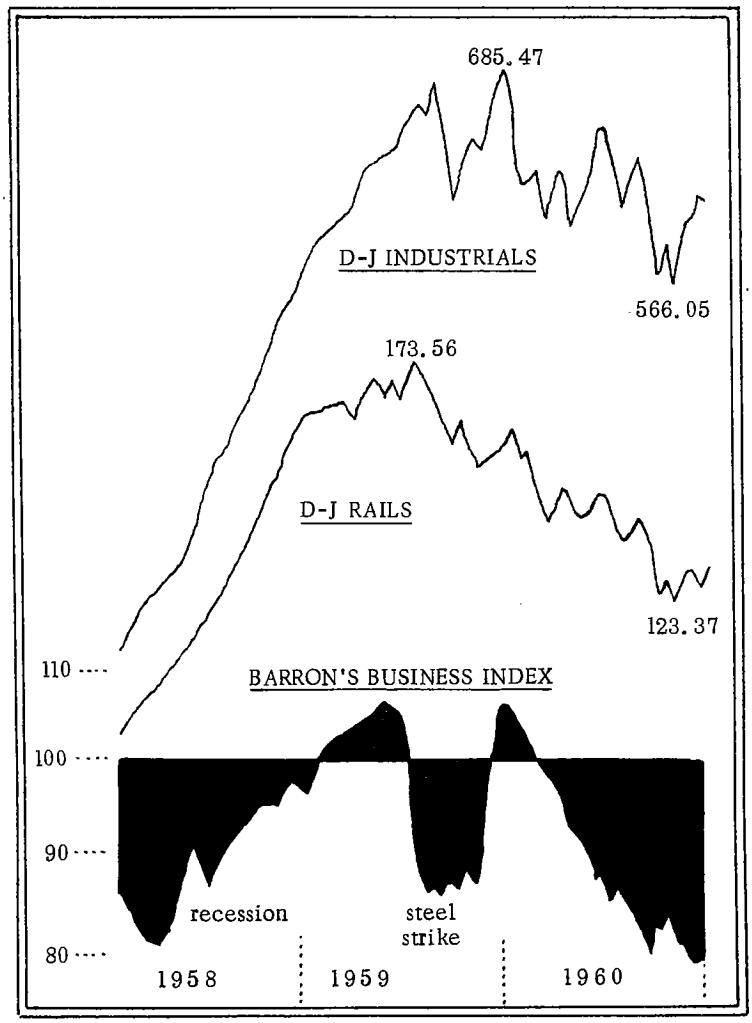
THE BAROMETER Throughout this series of Letters I have attempted to show that the major movements of the Averages foreshadow important expansions or contractions in the economy. This section will bring the study up to date. The primary trend turns up or down in response to broad economic tides, and these tidal movements may last from a year or two to as long as a decade. Secondary movements (against the tide) are frequently technical in nature, and as such they do not necessarily provide economic forecasts.

Occasionally, however, important secondary reactions precede secondary changes in business, but these are usually not drastic or extended.

The accompanying chart traces the pattern of Barron's Business Index and the D-J Averages from 1958 to the present. Although the Averages "bottomed" in late 1957, the chart shows that Barron's Business Index did not turn up until April, 1958. Business conditions continued to expand into 1959, following which the nation's longest steel strike forced a general curtailment (summer of 1959).

Subsequent to the steel settlement a short flurry of business activity advanced Barron's Index to 106 (January, 1960). This figure about equalled the peak in business which was registered just prior to the steel strike. Note that the Rails had never confirmed the new high of 685.47 (Industrials) recorded in January, 1960. As stated in these Letters (November-January), this non-confirmation by Rails cast serious doubts on the probability of "The Soaring Sixties".

In the first quarter of 1960 the Averages confirmed the existence of a bear market. As has been the case throughout history, there was little in the economic picture (at the time) to suggest an impending slowdown in business. On the contrary, the leading economists in the nation were quick to insist that the market "...was not saying anything, particularly since the Averages can't turn down in the face of good business." Of course the Averages were looking ahead of the forecasts, and towards summer the "adjustments" became rather obvious. During the third quarter Barron's Index (reflecting poor showings in steel, petroleum and coal production and lower carloadings) actually broke below the lows recorded in the 1957-58 recession.



The current situation finds many of the same forecasters who were wrong in 1960 insisting that "the bad news is out". Such diversified seers as Fortune Magazine and McGraw-Hill have taken space in national magazines to proclaim that 1961 will see "the turn", and while their 1960 forecasting record leaves something to be desired, one can only marvel at their courage.

FOREIGN MARKETS This writer makes no claim to being an expert on international markets. Except for correspondence from some of my knowledgeable overseas subscribers, I receive no "inside information" on the state of affairs in other nations. However, I do keep charts of the stock averages of leading exchanges in the free world. Strangely enough, I doubt if there are a dozen men in the country who do the same. (Try asking your bank or broker about the trend of the Paris Bourse).

For my own part, I would not trade my foreign charts for 95% of all the investment facts that come out of Europe. For instance, anybody who knows markets could have foreseen that Italy was heading for trouble when her exchange swung wildly from 503 to 946 in 1960. And the chart shows that the trouble came, for in four short months the Italian market broke from 946 to a recent 545 (see chart). Regardless of what I may read in the newspapers, I now know that fundamentals have changed in Italy and that Investors are protecting themselve against forthcoming events.

By the same token, Japan's market is careening wildly, and it is the only major exchange in the free world which is near the 1960 highs. Time alone will tell whether this type of "white heat" can be sustained.

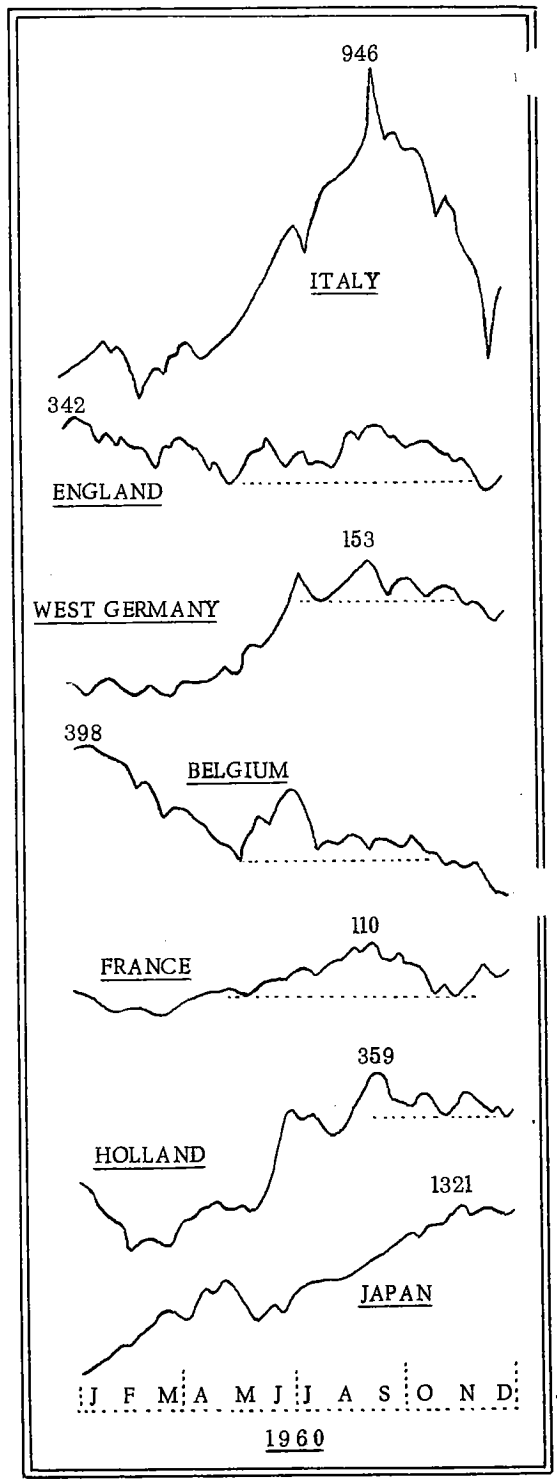
England's market was discussed in Letters 124 and 125. Since the break to the lows, the London market has crept higher on extremely low volume.

Despite the widely held opinion that all is well in West Germany, one notes that their stock average has been zig-zagging lower. France seems to be recovering from a secondary reaction or a bear swing, and it will be interesting to see whether their recent lows will hold or not. Much the same can be said of the important Dutch market.

Belgium has made the headlines in a dramatic way recently, and the talk is that the trouble has stemmed from her loss of part of the Congo. But Belgium has been living beyond her means for many years, and the part of the Congo which was lost actually had been costing Belgium money while Katanga province continues to bring in income.

From all indications Belgium is in a bear market, and except for a violent rally during June and July, 1960 (see chart), the Belgium exchange has been under liquidation all year.

Unfortunately, none of the foreign exchanges have rail averages to confirm the movements of their broad industrial indices, but perhaps the mere profiles of seven exchanges offer enough evidence from which to draw conclusions. All the charts shown here are drawn to logarithmic scale so that they show percentages of movement. Numbers on charts represent the 1960 high for each average. The statistics for charting these averages are provided daily by the London Financial Times (with the exception of Japan).



QUESTION "The Wall Street Journal and Barron's publish statistics on the daily volume of transactions in each of the Dow Jones Averages. Do you consider the volume indications in one Average alone to be significant?"

ANSWER I have studied volume on the individual Averages over a considerable period of time, and I have never been able to draw valid conclusions from these studies. It seems to me that the stocks in one Average are often accumulated under the disguise of weakness or inactivity in the other. The same may be said of distribution. In general, I would say that conclusions drawn from volume indications in a single Average are apt to be misleading as conclusions drawn from the movements in a single Average.

(Written Monday, January 9th - 2 P.M.)